

Message Text

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ACTION TRSE-00

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AID-05 EB-07 NSC-05 CIEP-01 SS-15 STR-04 OMB-01

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FOR NAC AGENCIES

E.O. 11652: ADS, DECLAS

TAGS: EAID, EFIN

SUBJECT: PROPOSED ADB SUPPLEMENTARY LOAN - FIRST AND SECOND
MINDANAO POWER PROJECTS (PHILIPPINES)

REFS: A. MANILA 6273

B. MANILA 2641

C. DEPT TREAS 132220Z MAR 75

SUMMARY: ADB MANAGEMENT HAS RECOMMENDED FINANCING OF
FOREIGN EXCHANGE PORTION OF COST OVERRUNS ON FIRST AND
SECOND MINDANAO POWER PROJECTS. IN VIEW OF BANK'S
SUCCESS IN OBTAINING CONTRIBUTION FROM JAPANESE EXIM BANK
TOWARD MEETING THESE COSTS, PHILIPPINE CONTRIBUTION TO
FINANCING OF OVERRUNS ON THESE AND OTHER ADB PROJECTS AND
CURRENT DIFFICULT PHILIPPINE FOREIGN EXCHANGE SITUATION,
MISSION RECOMMENDS THAT U.S. SUPPORT FINANCING PROPOSAL.

1. AS REPORTED REF A, ADB MANAGEMENT HAS MADE CAREFUL
REVIEW OF PHILIPPINE APPLICATION FOR FINANCING
OF COST OVERRUNS ON BANK'S FIRST AND SECOND MINDANAO
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POWER PROJECTS. SEVERAL CONCLUSIONS EMERGE FROM

THAT REVIEW:

A) INCREASE IN PROJECT COSTS IS RESULT OF SHARP INCREASES IN PRICES OF DOMESTIC AND FOREIGN COMPONENTS OF PROJECT. NEITHER THE STEEPNESS OF PRICE RISES NOR THEIR EFFECT ON PROJECTED COSTS IS OPEN TO QUESTION. MOREOVER, NOTHING IN RECORD INDICATES THAT BANK'S TECHNICAL STAFF COULD REASONABLY HAVE BEEN EXPECTED TO ANTICIPATE PRICE INCREASES OF ORDER ENCOUNTERED.

B) BANK HAS MADE EXTENSIVE AND SUCCESSFUL EFFORT TO OBTAIN ALTERNATIVE SOURCES OF FINANCING FOR PROJECT. IN ADDITION TO GOP PROVIDED FUNDS, JAPANESE EXIM BANK IS PROVIDING \$9.6 MILLION TOWARD FOREIGN EXCHANGE COST OF SECOND PROJECT.

C) GOP RECORD ON COST OVERRUN FINANCING IS EXCELLENT. FOR THESE TWO PROJECTS GOP WILL FINANCE LOCAL COST OVERRUNS ESTIMATED AT \$41.4 MILLION AND \$1 MILLION OF ESTIMATED FOREIGN EXCHANGE COST OVERRUN. FURTHER, AS REF A NOTES, ON TWO OTHER ADB PROJECTS GOP HAS ASSUMED BURDEN OF FINANCING FOREIGN EXCHANGE OVERRUN OF \$27.4 MILLION IN ADDITION

TO BEARING BURDEN OF LOCAL COST OVERRUN.

2. THE TWO ADB FINANCED MINDANAO POWER PROJECTS ARE IMPORTANT PARTS OF PHILIPPINE DEVELOPMENT PROGRAM. THE BANK'S ASSISTANCE FOR THESE PROJECTS IS CONSISTENT WITH PHILIPPINE DEVELOPMENT NEEDS AS REVIEWED AT MOST RECENT MEETING OF PHILIPPINE CONSULTATIVE GROUP. RECENT DEVELOPMENTS IN EXTERNAL SECTOR AS CITED IN REFTTEL A, MOREOVER, ACCENTUATE PHILIPPINE NEED FOR ASSISTANCE IN MEETING FOREIGN EXCHANGE COMPONENT OF PROJECT COSTS. PHILIPPINE AUTHORITIES ANTICIPATE DRAWING UP TO \$500 MILLION ON MEDIUM TERM CREDIT LINES THIS YEAR TO FINANCE TRADE DEFICIT. FURTHER DRAWINGS ON THESE LINES TO FINANCE FOREIGN EXCHANGE COSTS OF LONG GESTATION PROJECTS DO NOT LIMITED OFFICIAL USE

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APPEAR CONSISTENT WITH SOUND DEVELOPMENT POLICY OR ECONOMIC MANAGEMENT.

3. MISSION STRONGLY RECOMMENDS THAT NAC AUTHORIZE U.S. DELEGATION TO SUPPORT PROPOSED SUPPLEMENTARY LOAN. BANK HAS MADE ENTIRELY FORTHCOMING RESPONSE TO U.S.G. PROMPTING TO GUARD AGAINST MISUSE OF COST OVERRUN FINANCING. SIMILARLY, GOP IS PROVIDING TO PROJECT ALL THE

RESOURCES ITS CURRENT ECONOMIC POSITION COULD REASONABLY
SUSTAIN. PROPOSED FINANCING IS CLEARLY NECESSARY TO
PROJECT'S SUCCESS. GIVEN BANK'S EFFORTS AND GOP
CONTRIBUTIONS, MISSION BELIVES FAVORABLE VOTE BY U.S.
DELEGATION ON BANK PROPOSAL IS FULLY JUSTIFIED.
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